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SEC/SRO UPDATE: NEW GOVERNANCE FOCUS—DIRECTOR COMPENSATION; THE TIME IS NOW... CHECK YOUR SEVERANCE AGREEMENTS

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New Governance Focus—Director Compensation

The corporate governance focus has traditionally been on executive compensation, rather than on director compensation. Compensation Discussion and Analysis and executive compensation tables in proxy statements, say-on-pay votes, new pay ratio rules requiring disclosure of the ratio of the median of the annual total compensation of all employees of the company (except the CEO) to the CEO's annual total compensation, and Securities and Exchange Commission's (SEC's) proposed rules related to pay for performance and clawbacks are all aimed at providing stockholders with detailed information to assess, and express their point of view, on the company's executive compensation.

However, until recent settlements of shareholder litigation involving director compensation, the director compensation table has been the only disclosure related to director compensation in a company's SEC filings. Settlements of these lawsuits may lead to significant changes in corporate governance practices and enhanced proxy statement disclosures related to director compensation. For example, in 2016 settlement of its derivative shareholder lawsuit, Citrix Systems, Inc. agreed[1] to implement the following Corporate Governance Reforms:

- impose limits on the grant-date value of the annual equity compensation grant awarded to each non-employee director, which would require an amendment to Citrix's Equity Incentive Plan to add a new section that specifically addresses the annual equity compensation grants to non-employee directors and provides that the annual equity compensation grant awarded to each non-employee director will not have a value that exceeds $795,000 as of the grant date (such amendment will be presented to the Citrix stockholders for

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approval at the 2017 annual stockholder meeting).

- provide enhanced disclosures on director compensation practices in its proxy statement, including, but not limited to:

  a) a description of the compensation philosophy and rationale underlying non-employee director compensation;

  b) the process by which decisions were made concerning non-employee director compensation, including the role and analysis of the independent compensation consultant retained by the Compensation Committee of the Board of Directors; and

  c) the specific annual awards of nonemployee director compensation in that particular year.

- amend the Compensation Committee Charter to provide that the Compensation Committee shall be responsible for:

  a) conducting an annual review and assessment of all compensation, including cash and equity-based compensation, paid by Citrix to the non-employee directors;

  b) engaging an independent compensation consultant annually to advise the Compensation Committee with regard to the cash and equity-based compensation of non-employee directors to be awarded, including with respect to (a) the amount and type of compensation to be paid, and (b) comparative data deemed appropriate by such consultant; and

  c) recommending to the Board of Directors on the basis of its annual review and assessment the compensation to be awarded to non-employee directors.

In addition, the proxy statement filed by Facebook, Inc. in connection with its June 2016 annual stockholders meeting, included the following proposals as a result of the settlement of a derivative lawsuit alleging that Facebook's non-employee directors received excessive director compensation in 2013:

- to ratify the 2013 grant of restricted stock units (RSUs) to non-employee directors; and

- to approve annual compensation program for non-employee directors.

Facebook also included in its 2016 proxy statement the proposal to ratify 2014 and 2015 grants of RSUs to non-employee directors on a voluntary basis. Such proposal was not required by the terms of the settlement, but Facebook considered it prudent to do so to avoid potential future litigation.

ISS has taken notice of these settlements, and its U.S. Summary Proxy Voting Guidelines, released on December 22, 2016,[2] included a new policy related to director compensation. Such policy "codified" ISS approach to evaluating management proposals to ratify non-employee director pay programs. For 2017 proxy season (*i.e.*, stockholders meetings held on or after February 1, 2017), ISS general recommendation is to vote case-by-case on management proposals

seeking ratification of non-employee director compensation, based on the following factors:

- the relative magnitude of director compensation as compared to companies of a similar profile;
- the presence of problematic pay practices relating to director compensation;
- director stock ownership guidelines and holding requirements;
- equity award vesting schedules;
- the mix of cash and equity-based compensation;
- meaningful limits on director compensation;
- the availability of retirement benefits or perquisites; and
- the quality of disclosure surrounding director compensation.

ISS Guidelines also updated the policy related to equity plans for non-employee directors to include new factors for evaluating certain director equity plans: (*i*) the relative magnitude of director compensation as compared to companies of a similar profile; and (*ii*) meaningful limits on director compensation. Such updated policy "aligns the considered factors with the same ones provided under ISS' new policy on proposals seeking ratification of non-employee director pay programs."

ISS expects to see more proposals related to director compensation to be included in proxy statements in 2017 in response to lawsuits involving the scrutiny of non-employee director compensation.

The Time is Now... Check Your Severance Agreements

The SEC Enforcement Division is once again taking action against companies with severance agreements which impede former employees from whistleblowing.

On December 19, the SEC announced that NeuStar Inc., a technology company, agreed to pay a penalty of $180,000 to settle charges involving non-disparagement clauses contained in their severance agreements that impeded employees from communicating with the SEC. According to the SEC's order, from August 12, 2011 to May 21, 2015, NeuStar entered into severance agreements with at least 246 departing employees. Such severance agreements contained a broad non-disparagement clause which prohibited former employees from engaging with the SEC and other regulators "in any communication that disparages, denigrates, maligns or impugns" the company. A separate provision of each agreement provided that former employees could have been compelled to forfeit all but $100 of their severance pay packages for breaching the non-disparagement clause. Upon commencement of the SEC's investigation, NeuStar voluntarily revised its severance agreements to delete the language restricting communications with the SEC.

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The SEC found that NeuStar violated Rule

21F-17 under the Exchange Act. Rule 21F-17, adopted pursuant to the Dodd-Frank Act, provides that "[n]o person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement. . . with respect to such communications."

NeuStar consented to the SEC's cease-and-desist order without admitting or denying the findings. In addition, NeuStar agreed to make reasonable efforts to contact former employees who had previously signed severance agreements and inform them that NeuStar does not prohibit them from communicating any concerns about potential violations of law or regulation to the SEC.

On December 20, the SEC announced that SandRidge Energy Inc., an oil-and-gas company, agreed to settle charges that it used illegal separation agreements and retaliated against a whistleblower who internally expressed concerns about how the company's reserves were being calculated. According to the SEC's order, the separation agreements used by the company since at least August 12, 2011 contained language which prohibited former employees from participating in any government investigation or disclosing information potentially harmful or embarrassing to the company. In addition, the SEC found that SandRidge fired an employee who internally raised concerns about the process used by SandRidge to calculate its publicly reported oil-and-gas reserves.

The SEC found that SandRidge violated Section 21F(h) of the Exchange Act and Rule 21F-17 under the Exchange Act. Section 21F(h)(1) of the Exchange Act prohibits an employer from taking retaliatory actions, either directly or indirectly, against a whistleblower who makes a report protected under, inter alia, the Sarbanes-Oxley Act of 2002.

Without admitting or denying the SEC's findings, SandRidge agreed to pay a penalty of $1.4 million, subject to the company's bankruptcy plan. Significantly, this was the first time a company was charged for retaliating against an internal whistleblower.

The SEC's recent enforcement actions highlight the SEC's commitment to ensuring that potential whistleblowers are free to communicate with the SEC. Companies should review their severance agreements to make sure that they do not impede whistleblowers from communicating with the SEC about possible securities law violations.

ENDNOTES:

[1]Stipulation of Compromise and Settlement on John Calma, Derivatively on Behalf of Citrix Systems, Inc. v. Mark B. Templeton, Thomas F. Bogan, et al., C. A. No. 9579-CB; Del. Chanc. Ct., May 12, 2016.

[2]U.S. Summary Proxy Voting Guidelines; Dec. 22, 2016; available at https://www.issgovernance.com/file/products/2017-us-summary-voting-guidelines.pdf.